

Memorandum

To: Mr. Dean Kinnee (MIC:64)
Chief, County-Assessed Properties Division

Date: July 21, 2009

From: Daniel Paul
Tax Counsel

Subject: Legal Entity Original Co-Owner Interest Transfer
Assignment No. 09-050

This is in response to your memorandum of March 20, 2009, wherein you requested our opinion regarding legal entity original co-owner interest transfers. As explained below, it is our opinion that once an “original co-owner” interest has been transferred, it ceases to be an original co-owner interest.

Factual Background

According to your memorandum, the facts are as follows:

Four persons equally owned real property as individuals. Around 1990, they transferred the real property to a partnership in a transaction that was excluded from change in ownership under section 62(a)(2). Thus, those four persons became original co-owners, each with 25 percent interest. In 2004, partner A deeded to the partnership his 25 percent interest, resulting in the remaining partners each owning a 33.33 percent interest in the partnership. In 2006, partner B transferred his 33.33 percent interest to the two remaining partners, C and D. Shasta County determined that this resulted in cumulatively more than 50 percent of original co-owner interest transferring and subjected the property to 100 percent reassessment. However, the taxpayer’s attorney is stating. . .that only 25 percent of partner B’s 33.33 percent interest transferred to the two remaining partners should be considered original co-owner interest and the remaining 8.33 percent should not be considered [an original co-owner] interest because it was obtained after the original transfer to the partnership. Thus, the attorney claims that no change in ownership has occurred because cumulatively no more than 50 percent of original co-ownership interests have transferred.

Law & Analysis

Article XIII A, section 2 of the California Constitution requires the reassessment of real property upon a “change in ownership,” unless an exclusion from change in ownership applies. A change in ownership is defined in Revenue and Taxation Code¹ section 60 as “a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.”

As a general rule, the transfer of any interest in real property to or from a legal entity is a change in ownership and results in reappraisal of the property transferred. (Rev. & Tax. Code, § 61, subd. (j); Property Tax Rule² (Rule) 462.180, subd. (a).) Section 64, subdivision (a) provides the general rule that the transfer of ownership interests in a legal entity, such as corporate voting stock or partnership interests, does not constitute a transfer of the real property owned by the legal entity, unless the exceptions, as relevant herein, contained in subdivisions (c)(1) or (d) of section 64, or subdivision (d)(4) of Rule 462.180, apply.

Section 62, subdivision (a)(2) provides an exclusion from change in ownership for proportional ownership interest transfers of real property between a legal entity and an individual. To qualify for the exclusion, such transfers must result solely in a change in the method of holding title to the real property, and the proportional ownership interests of the transferors and transferees must remain exactly the same both before and after the transfer in each and every piece of real property transferred. (Rev. & Tax. Code, § 62, subd. (a)(2); Rule 462.180, subd. (b)(2).)

Section 64, subdivision (d), as interpreted by Rule 462.180, subdivision (b)(2), provides that when a transfer of real property to a legal entity is excluded from change in ownership under section 62, subdivision (a)(2), each person holding an interest in that legal entity immediately after the excluded transfer becomes an “original co-owner” for purposes of determining the change in ownership consequences of any subsequent transfer(s) of that legal entity interest. “Original co-owner” status derives its source from the prior utilization of the exclusion for transfers into legal entities set forth in section 62, subdivision (a)(2). (Property Tax Annotation 220.0452.) Subsequently, whenever voting shares or other ownership interests representing cumulatively more than 50 percent of the total interests in the legal entity are transferred by any of the original co-owners in one or more transactions, a change in ownership occurs of that real property owned by the legal entity that was previously excluded from change in ownership under section 62, subdivision (a)(2). However, certain transfers of original co-owner interests are not counted or cumulated for purposes of determining whether more than 50 percent of original co-owner interests have been transferred. The transfers excluded from the counting and cumulation requirement are set forth in Rule 462.180, subdivision (d)(2), and are limited to interspousal transfers under section 63, trust transfers excluded from change in ownership under section 62, subdivision (d), and proportional interest transfers under section 62, subdivision (a)(2). Most notably, there is no exclusion from the counting and cumulation requirement for transfers between parents and children, or between original co-owners.

Board legal staff has previously concluded that when a transfer to a third party is cumulated and counted for purposes of section 64, subdivision (d), the third party does not become a original co-

¹ All statutory references are to the Revenue and Taxation Code unless otherwise indicated.

² Cal. Code Regs., tit. 18, § 462.180. All Rule references are sections to title 18 of the California Code of Regulations.

owner with respect to the obtained interests because the third party did not receive its interest in a transfer excluded from change in ownership by section 62, subdivision (a)(2), and that a subsequent transfer of the obtained interests is not counted or cumulated for purposes of section 64, subdivision (d). Consistent with that interpretation, it is our opinion that an interest in a legal entity is only an original co-owner interest if it was held immediately after a transfer that was excluded from change in ownership under the provisions of section 62, subdivision (a)(2), and if such an original co-owner interest has been subsequently transferred, the transfer was excluded from counting and cumulation under Rule 462.180, subdivision (d)(2).

In this case, when A transferred his partnership interests to B, C, and D in 2006, the transfers were not excluded from change in ownership by section 62, subdivision (a)(2) or, presumably, from counting and cumulation under Rule 462.180, subdivision (d)(2). The transfer of A's 25 percent interest should therefore be counted and cumulated for purposes of section 64, subdivision (d). However, since the other partners did not receive their respective 8.33 percent interests in a transfer that was excluded by section 62, subdivision (a)(2), or excluded from counting and cumulation, they are not original co-owners with respect to those interests; as relevant here, the 8.33 percent B obtained from A is no longer an original co-owner interest. Thus, only 25 percent of B's transferred interests are original co-owner interests, and the 8.33 percent B obtained from A should be excluded from counting and cumulation. Thus, after the transfer of B's entire partnership interest to C and D, only 50 percent of original co-owner interests in the partnership are counted and cumulated for purposes of section 64, subdivision (d), and there is no change in ownership of the partnership's previously excluded real property as a result of B's transfer.

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cc: Mr. David Gau MIC:63
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